

# Memorandum to Parliamentary Standing Committee on Finance

*from Cooperative Development Foundation*

*Hyderabad, Andhra Pradesh, on*

## Micro Financial Sector Development and Regulation Bill 2007

### 1. *The Bill needs to be dropped and an appropriate Bill needs to be evolved:*

The Micro Financial Sector Development and Regulation Bill 2007 (MF Bill), in its present form, has no merits. It is not only ill conceived but also ill drafted. There is absolutely no possibility of improving the bill. It is beyond redemption. Therefore, it is absolutely necessary to evolve a new Bill that has an appropriate statutory mechanism for incorporation, regulation and winding up of micro finance institutions and their micro financial services in the country. The entire new exercise has to be in public domain, even though the final enactment of a law is in the exclusive domain of the Union Parliament. While suggesting an open debate, dialogue, discussion, etc, it is not our intention to encroach upon the rights and the privileges of the executive wing and/or the legislative wing of our government.

### 2. *Fundamental flaw in the present MF Bill:*

There is a fundamental flaw in the MF Bill 2007. The Bill tries not only to sanctify but also perpetuate “micro financial services” and “micro financial services + thrift services = micro banking services” that are being provided by a variety of civil society organisations [(CSOs) which are widely known as non government organisations (NGOs)] in general and in particular by

- (a) **societies** registered under the Societies Registration Laws;
- (b) **private trusts** created under the Indian Trusts Act 1882; and
- (c) **public trusts** registered under the Public Trusts Laws.

These entities (societies, private trusts, public trusts), along with some other similar entities [e.g. section 25 companies (S25Cs)] are a vibrant part of **civil society vis-à-vis market and government**. They are not designed nor expected to be a part of market in which companies, cooperatives, partnership firms, etc do have a legitimate and rightful role. To reiterate the point, let us be clear that societies, private trusts, public trusts, S25Cs, etc are part of civil society, whereas companies, cooperatives, partnership firms, nidhis (i.e. section 620A companies), etc are part of market. To put these two sets of entities in one basket for the purpose of providing micro financial services is a massive blunder as far as the country's financial sector is concerned. By enabling societies, private trusts, public trusts, S25Cs and similar entities to enter market, we will be opening floodgates for committing financial frauds of immense magnitude.

### 3. *Concepts and constitutional provisions:*

At this particular juncture, the most critical issue before us is that of stopping or of sanctifying and perpetuating micro financial activity of the entities like

societies, private trusts, public trusts, S25Cs, etc. It is conceptually and constitutionally impermissible and undesirable to “validate, legitimise and legalise” micro financial activities of these entities that have been, knowingly or unknowingly, carrying on the micro financial activities for more than a decade. Allowing these entities to do so all these years, with active encouragement and connivance of the Reserve Bank of India (RBI), the National Bank for Agriculture and Rural Development (Nabard), the Small Industries Development Bank of India (Sidbi), the so-called new generation private banks (e.g. ICICI Bank, HDFC Bank, IDBI Bank, Yes Bank), etc is a mischievous misadventure. A bigger and more mischievous blunder will be committed if we perpetuate this invalid, illegitimate and illegal activity of these entities, by converting the present MF Bill into an MF Act.

4. *Section 25 Companies (S25Cs) and their micro financial activity:*

No one seems to be clear about the existing regulatory mechanism for the section 25 companies (S25Cs) that have been providing micro financial services. Apparently, there seems to be no specific regulation of micro financial activity of S25Cs presently. However, it is a moot point whether the micro financial activity of S25Cs is to be regulated or not when, indeed, the S25Cs are not meant for providing any financial services - macro or micro.

5. *Several provisions of the MF Bill are patently ambiguous:*

It will not be of much use to dwell on various provisions of the Bill when we recognise that there is a basic, fundamental and genetic flaw in the scheme of the proposed legislation - a flaw that cannot be ignored, that cannot be removed, that cannot be rectified. However, it is better to have a relook at the definitions and implications of various words and expressions used in the Bill:

- (a) eligible clients [section 2(b)] *vis-à-vis* other individuals [section 2(f)(i)];
- (b) financial assistance [section 2(c)] *vis-à-vis* financial service [section 2(f)(ii)];
- (c) group [section 2(d)] *vis-a-vis* group mechanism [section 2(f)(i)];
- (d) micro finance organisation (MFO) [section 2(e)];
- (e) micro finance services [section 2(f)] *vis-a-vis* thrift services [section 2(l)];
- (f) insurance services [section 2(f)(iii)];
- (g) pension services [section 2(f)(iii)];
- (h) micro finance development council (MFDC) [chapter II];
- (i) Nabard as the regulatory authority [chapters III, IV, and V];
- (j) micro finance development and equity fund (MFDEF) [chapter VI];
- (k) provisions of the proposed legislation to override other laws [section 32] *vis-à-vis* application of other laws not barred [section 36];
- (l) winding up micro finance organisation (MFO) under the proposed legislation [section 13(1)] *vis-à-vis* under the parent laws like Societies

Registration Act, Private Trusts Act, Public Trusts Act, Cooperative Societies Act, Companies Act.

6. *Do various provisions of the MF Bill withstand constitutional scrutiny?*

The most critical issue before us is: whether the legal entities that come into existence under various union and state laws relating to societies, private trusts, public trusts, firms, trade unions, etc can be enabled by an union law and/or by a state law to take up the activities like (a) micro financial services, (b) thrift services, (c) credit services, (d) financial assistance, (e) financial services, (f) life insurance services, (g) general insurance services, (h) pension services, (i) remittance services, etc that may not be directly related to the main objects and reasons of the laws that have been enacted to enable citizens to form the above mentioned legal entities to pursue the objectives that are permitted by a particular statute that is within the ambit of the constitutional provisions. Will the statutory enablement of these entities to get involved in the banking, insurance, and pension services withstand conceptual and constitutional scrutiny? Our answer, we are afraid, is no.

7. *Do not perpetuate an activity that cannot be sanctified:*

In our view, the sole objective of the MF Bill is to sanctify and perpetuate various measures [(a) micro financial services through civil society organisations, (b) the business facilitator and business correspondent mechanism, (c) banking ombudsman scheme, etc] that have been introduced by the Reserve Bank of India in the banking sector through administrative proceedings. The RBI and the Nabard in a casual as well as a cavalier fashion introduced all these measures. The Union Parliament is not meant to validate, legalise, legitimise, and perpetuate these measures that are patently ill-conceived and mal-administered. The first measure is patently illegal and unconstitutional and the other two measures need to be studied thoroughly.

8. *Enact a law that will be conceptually and constitutionally valid:*

In the present context, Entry 43 in List 1 of Schedule VII of the Constitution that speaks of “incorporation, regulation and winding up of financial corporations, etc” comes in handy to the Union Government.

- (a) It may enact an alternate law that will enable incorporation, regulation and winding up of micro finance institutions (MFIs) and their corporate affairs as well as business activities.
- (b) The alternate law should not only enable incorporation of new MFIs under that law itself but also enable the aforesaid entities (societies, private trusts, public trusts, S25Cs, etc) that are already in the business of micro finance to move into the new law as MFIs along with their micro financial activity.
- (c) The alternate law should also enable these entities to divest themselves of their micro financial activity and move that activity to an existing MFI or to a newly formed MFI under the new law and they themselves continue

under the existing legal dispensation to carry on the works that are permissible, legitimate and desirable under their respective parent laws.

- (d) The alternate law should also enable NBFC-MFIs, which presently get incorporated under the Companies Act and get regulated under the RBI Act, to move into new law and new regulation as MFIs.

In simple terms, the MFIs as legal entities will take birth under the new law, their activities will be regulated under the same law, and they wind up themselves and their activities under the same law. There will be absolutely no dual or triple control. Single authority will do the incorporation, regulation and winding up of MFIs and their activities. This process will perfectly be in order and conceptually and constitutionally valid.

*9 Move ahead in the right path:*

Let us move ahead for promotion, development and regulation of micro financial services through micro financial institutions (MFIs) that are designed specifically for that purpose. All attempts for half-baked micro finance legislation are bound to fail with disastrous effects on our financial sector. The CDF's proposal envisages smooth closure of micro financial activities of societies, private trusts, public trusts, and of similar institutions or smooth migration of such entities into the purview of the alternate law or smooth transfer of micro financial activities of such entities to entities that will be incorporated under the alternate law.

*10. The bounden duty of the parliamentarians:*

It need not be reiterated here that it is the basic and fundamental responsibility of the parliamentarians to enact laws that are practicable and long lasting. The larger public interest should not be overlooked for short term gains, if any.

*11. Clause-by-clause comments on the MF Bill:*

Attached to this memorandum is a table that contains clause-by-clause comments of Cooperative Development Foundation (CDF) on the contents of the MF Bill. It may kindly be treated as part and parcel of this memorandum.

*12. Request for Direct interaction with Committee:*

We request the Parliamentary Standing Committee on Finance to give us an opportunity to have a direct interaction with the Committee.

Rama Reddy<rama.reddy@sahavikasa.coop>

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